No. 85-521

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

OTIS R. BOWEN, Secretary of Health and Human Services, *et al.*,
Appellants,

v.

PUBLIC AGENCIES OPPOSED TO SOCIAL SECURITY ENTRAPMENT, *et al.*,
Appellees.

UNITED STATES OF AMERICA, *et al.*,
Appellants,

v.

STATE OF CALIFORNIA,
Appellee.

On Appeal from the United States District Court for the Eastern District of California

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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, U.S. CONFERENCE OF MAYORS, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, AND NATIONAL LEAGUE OF CITIES AS *AMICI CURIAE* IN SUPPORT OF APPELLEES

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QUESTION PRESENTED

Whether Congress may, consistent with federal common law and the Fifth Amendment, unilaterally abrogate existing contractual rights of States to terminate voluntary agreements with the federal government concerning participation of States and their local subdivisions in the Social Security system?

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INTEREST OF *AMICI CURIAE*

The *amici*, organizations whose members include state, county, and municipal governments and their officials throughout the United States, have a vital interest in legal issues that affect state and local governments.

This case is about process. It raises the question whether the United States may seek permissible goals through the expedient of legislatively abrogating its contracts with state and local governments. A 1950 amendment to the Social Security Act offered state and local governments the opportunity to enter into agreements for voluntary coverage of their employees. Appellee California executed such an agreement, which expressly gave the State the right to withdraw from coverage upon two years' notice to the Secretary of Health, Education, and Welfare (now Health and Human Services). The district court held that this contractual right to withdraw was a property right within the meaning of the Fifth Amendment. Accordingly, the district court held that the explicit elimination of this right in a 1983 amendment to the Act was a taking of private property for which the federal government must pay just compensation. The court directed the Secretary to accept the notices of withdrawal in lieu of payment of compensation.

Amici submit that the decision below is clearly correct. The district court noted the limited issue before it: whether Congress could unilaterally "take" the contractual right to withdraw from the federal pension system. Congress could have chosen any number of courses of action to maintain the viability of the Social Security system, and still could choose other courses, upon this Court's affirmance of the judgment below. Thus, the question before this Court is not the highly emotional and difficult policy issue of the solvency of the Social Security system. It is rather an issue of process, involving the denial of contract rights and the attempt to treat state and local governments as less than full partners in our system of federalism.

Specifically at issue in this case are termination notices from 71 political subdivisions in California covering approximately 33,750 employees. Adding other ter-

mination notices pending at the time of the 1983 amendment, 227,000 employees will be immediately affected by this Court's decision. In all, nine million state and local government employees who are currently enrolled in the Social Security system may ultimately be affected by the decision in this case. (J.S. 8-9.) Because reversal of the decision below will have a direct and immediate adverse effect on matters of compelling importance to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.[1]

STATEMENT

1. As originally enacted, the Social Security Act of 1935 excluded from coverage all employees of state and local governments, primarily because of questions about the constitutionality of any general levy of the employer tax on States and localities. Subcomm. on Social Security of the House Comm. on Ways and Means, 97th Cong., 2d Sess., WMCP: 97-34, *Termination of Social Security Coverage for Employees of State and Local Government and Nonprofit Groups* 20 (Comm. Print 1982) [hereinafter cited as H.R. Comm. Print 97-34]. During the 1940's, a political consensus emerged that coverage of the Social Security system could be extended to such employees only through voluntary agreements with state and local governments. *Ibid.*

The result of this consensus was the Social Security Act Amendments of 1950, ch. 809, § 106, 64 Stat. 514 *et seq.*, codified at 42 U.S.C. (& Supp. I) 418 [hereinafter the "1950 Amendments"]. In light of the strong political and constitutional objections of States, local governments, and their employees to any mandatory participation, Congress recognized that "coverage had to be voluntary." H.R. Comm. Print 97-34, at 2. Section 106

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[1] Pursuant to Rule 36 of the Rules of the Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

of the 1950 Amendments, which added section 218 to the 1935 Act, 42 U.S.C. (Supp. I) 418 [hereinafter "Section 418"], reflected this congressional intent. Section 418 was entitled "Voluntary Agreements for Coverage of State and Local Employees," and provided, in pertinent part:

> (a)(1) The Administrator shall, at the request of any State, enter into an agreement with such State for the purpose of extending the insurance system established by this title to services performed by individuals as employees of such State or any political subdivision thereof. Each such agreement shall contain such provisions, not inconsistent with the provisions of this section, as the State may request.

Under the 1950 Amendments, a State could opt to enroll within the system all, or only specified "coverage groups," of eligible state and local employees. 42 U.S.C. 418(b)(5). A State electing to enter into a voluntary agreement for coverage was required to collect and pay to the Secretary of the Treasury "amounts equivalent to the sum of the taxes" that would be due if the covered employees were otherwise subject to the Act. 42 U.S.C. (Supp. I) 418(e)(1).

"Consistent with the voluntary approach to coverage of these groups of employees, the 1950 Amendments also provided that a State could terminate the coverage of its own employees or the employees of any political subdivision, at the instigation either of the State or at the request of the political subdivision itself." H.R. Comm. Print 97-34, at 20. The right to withdraw, seen by Congress as a "necessary corollary" to the voluntary nature of the system (*id.* at 3), was provided in Section 418(g). The States were given the right to terminate the voluntary agreements, in whole or part, upon two yaers' notice to the Administrator of the system (now the Secretary of Health and Human Services). 42 U.S.C. 418(g)(1). The option to terminate, however, could not be exercised until the voluntary agreement had been in

force for five years (42 U.S.C 418(g)(1)(A) and (B)); once a group's coverage had terminated, that group could not be re-enrolled in the system. 42 U.S.C. 418(g)(3).[2]

2. Effective January 1, 1951, the State of California and the United States executed a written agreement (the "1951 Agreement") providing for the extension of Social Security coverage to specified state and local "coverage groups." The 1951 Agreement, signed by California's Director of Finance on behalf of the State and by the Acting Federal Security Administrator on behalf of the United States (J.A. 29-33), contained a paragraph entitled "Termination by the State." That paragraph, in accordance with the provisions of the 1950 Amendments, allowed the State to terminate the agreement, either in its entirety or with respect to any coverage group, upon two years' advance notice. (J.A. 31.)[3] In order to carry out its obligations under the 1951 Agreement, California then enacted detailed enabling legislation. Cal. Gov't Code §§ 22000-22603 (West 1980 & Supp. 1985). Pursuant to that legislation and the 1951 Agreement, California entered into individual agreements with those public agen-

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[2] As the Secretary notes, the 1950 Amendments generally left to the States the decision as to which coverage groups would be included in an agreement, as well as the decision whether a notice of termination would be filed. (U.S. Br. at 4-5.) However, California, as noted below, made such decisions solely on the basis of the wishes of the affected subdivisions.

[3] Section (F) of the 1951 Agreement provides:

> The State, upon giving at least two years' advance notice in writing to the Administrator, may terminate this agreement, either in its entirety or with respect to any coverage group, effective at the end of a calendar quarter specified in the notice, provided, however, that the agreement may be terminated in its entirety only if it has been in effect not less than five years prior to receipt of such notice, and provided further that the agreement may be terminated with respect to any coverage group only if it has been in effect with respect to such coverage group for not less than five years prior to receipt of such notice.

cies wishing to participate in the program. (J.S. App. 5a.)

Under these agreements, the public agencies promised to reimburse the State for the costs of their participation in the system. The agencies were allowed to withdraw from the state agreements (and thus the system) upon two years' advance notice.

The 1951 Agreement has been modified on some 1,217 occasions. (J.A. 50.) The vast majority of these modifications were to add or delete particular coverage groups. *Ibid.* Five of the modifications, however, were substantive amendments to the original Agreement. (J.A. 34-42, 50.) These modifications were in traditional contract form, signed by representatives of both the United States and the State of California. (J.A. 34-42.)

3. Like California, each of the States entered into voluntary agreements with the United States concerning Section 418 coverage of specified state and local employees.[4] The first termination by a State of coverage of a political subdivision occurred in 1959. (H.R. Comm. Print 97-34, at 26.) Terminations gradually increased thereafter on an annual basis until the mid-1970's (*ibid.*), but in each year, the total number of employees entering the system greatly exceeded the number leaving the system through terminations. *Id.* at 23, 24.

The last year in which the number of newly covered positions exceeded those covered by termination notices was 1976. *Id.* at 23. In the six years thereafter, the number of governments filing termination notices increased, and, in each such year, the number of employees terminating coverage exceeded those who were newly covered. *Id.* at 23-26. By 1983, termination notices were pending for 634 state and local entities (H.R. Rep. No.

[4] Maine, Massachusetts, Nevada, and Ohio did not choose to include state employees within their voluntary agreements, but did cover one or more political subdivisions. (J.A. 59.)

25, 98th Cong., 1st Sess., Pt. 1, 18 (1983)); 287 of these notices would become effective, according to the terms of the applicable voluntary agreements, by the end of 1983. (J.A. 61.) At the request of its political subdivisions, California had filed 71 termination notices on behalf of some 33,750 local government employees. (J.A. 61.) These notices were, according to the explicit terms of the 1951 Agreement, to become effective at the end of 1983.[5]

4. Noting that the terminations posed the risk of a substantial loss of revenue to the Social Security system (H.R. Comm. Print 97-34, at 13-14), Congress in 1982 considered a number of possible restrictions on termination activity. *Id.* at 15-17. The possibility of imposing mandatory coverage of all state and local employees was considered, as was the possibility of allowing withdrawal only after notification to and a vote by affected employees. *Id.* At the same time, Congress considered simply eliminating the option for voluntary termination in the various agreements. *Id.* at 16-17. The Subcommittee on Social Security of the House Committee on Ways and Means cautioned that such a course would raise "constitutional ramifications [which] can ultimately be decided only by the Supreme Court." *Id.* at 16-17.

Notwithstanding this concern, Congress, in 1983, as part of the Social Security Amendment Act of 1983 [hereinafter the "1983 Amendment"], Pub. L. No. 98-21, 97 Stat. 65 *et seq.*, amended Section 418(g) to nullify the voluntary termination provision of the 1951 Agreement and the various other voluntary agreements. Section 103 of the 1983 Amendment provided:

> (a) Section 218(g) of the Social Security Act is amended to read as follows:

[5] One State, Alaska, terminated coverage for *state* employees, while continuing coverage for employees of certain political subdivisions. (J.A. 59.)

"Duration of Agreement

"(g) No agreement under this section may be terminated, either in its entirety or with respect to any coverage group, on or after the date of enactment of the Social Security Amendments of 1983."

(b) The amendment made by subsection (a) shall apply to any agreement in effect under section 218 of the Social Security Act on the date of the enactment of this Act, without regard to whether a notice of termination is in effect on such date, and to any agreement or modification thereof which may become effective under such section 218 after that date.[6]

5. In the wake of the enactment of the 1983 Amendment, these suits were commenced in the United States District Court for the Eastern District of California to challenge the validity of Section 418(g), as amended. The plaintiffs in the first suit were several public agencies of the State of California, their employees and local taxpayers, and a group called Public Agencies Opposed to Social Security Entrapment ("POSSE"). These plaintiffs claimed, *inter alia*, that the 1983 Amendment deprived them of contract rights under the Agreement without just compensation; that the enactment deprived them of contract rights without due process of law; that the Amendment violated the Tenth Amendment; and that the United States had breached its contractual duties under the 1951 Agreement. (J.A. 7-21.) The plaintiff in the second suit was the State of California, which alleged that the 1983 Amendment violated the Tenth Amendment and was a breach of the contractual duties of the United States under the 1951 Agreement. (J.A. 22-28). Each action sought appropriate injunctive and declaratory relief.

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[6] The effective date of the 1983 Amendment was April 20, 1983. (Pub. L. No. 98-21, § 103(b), 97 Stat. 72.)

The district court granted summary judgment to the plaintiffs. The district court began by holding that not only the State, but also the public agencies and their employees, had standing to raise the claims set forth in the complaints.[7] The district court held that the right to terminate the 1951 Agreement on two years' notice "is a contractual right running in favor of the public agencies." (J.S. App. 21a.) Citing the settled rule that "rights which arise out of contracts with the United States are 'property' within the meaning of the Fifth Amendment" (J.S. App. 19a), the district court held that the 1983 Amendment was invalid, since "Congress clearly and explicitly intended to deprive the plaintiffs of their right to withdraw from the contract." (J.S. App. 33a.)[8]

In holding for the appellees, the district court was careful to note the limited scope of its judgment. The district court assumed, *arguendo*, that Congress had the power to force state and public agencies to provide Social Security coverage to their employees, citing *Garcia v. San Antonio Metropolitan Transit Authority*, —— U.S. ——, 105 S.Ct. 1005 (1985). Such legislation, the court assumed, would pass constitutional muster because the State's *contractual* right to withdraw from the 1951 Agreement would be unimpaired, even though such termination would be ineffective in light of a newly imposed

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[7] The Secretary suggested in a footnote in his Jurisdictional Statement that the various POSSE plaintiffs were not properly before the district court. (J.S. 10 n.9). The Secretary's brief on the merits, however, does not challenge the district court's ruling as to standing, other than by making passing reference to that footnote. (U.S. Br. at 17 n.15.)

[8] The district court noted that Congress provided no means of compensation for depriving plaintiffs of that right. The court refused to remit plaintiffs to a suit in the Court of Claims to seek "just compensation," since the legislative history of the 1983 Amendment plainly demonstrated that Congress had no intent to authorize such compensation. (J.S. App. 33a-34a.)

general *statutory* obligation to participate in the system. The 1983 Amendment, however, was not such legislation. Rather, it was specifically designed to divest the appellees of their contractual right to terminate participation. For this reason, and this reason alone, the district court found the 1983 Amendment invalid. (J.S. App. 3a-4a, 31a-32a.)

SUMMARY OF ARGUMENT

1. The sole issue presented by this case is whether Congress may unilaterally abrogate the right to withdraw contained in the 1951 Agreement. The case does not involve Congress' general power to subject state and local employees to coverage under the Social Security system. The case does not involve a contention that the 1950 Amendments, in and of themselves, created a contract between the appellees and the United States. Nor is the issue presented whether the 1983 Amendment somehow unconstitutionally impairs contracts between private parties. Rather, the narrow issue before the Court is whether the United States may unilaterally repudiate its *own* contractual promises.

2. The 1951 Agreement plainly is a contract between the United States and the appellees. It has all the facial indicia and legal characteristics of a contract: it is reduced to written form, deals with a proper subject, is signed by the responsible parties, and involves the exchange of consideration. Moreover, the 1950 Amendments, by their very terms, clearly presupposed that coverage of the Social Security system would only be extended to state and local employees through such "voluntary agreements."

As in the case of all contracts, the 1951 Agreement resulted from the voluntary decision of California to obtain certain benefits for itself, in return for specified consideration, on specified terms and conditions. The right to terminate the Agreement on two years' notice

was an integral part of the contract, and was found by the district court to be one of the "motivating causes" of the State's decision to enter into the Agreement.

3. Once the United States enters into a contract, it is as much bound by its promises as any individual. *Sinking-Fund Cases*, 99 U.S. (9 Otto) 700 (1879); *Lynch v. United States*, 292 U.S. 571 (1934). Such contracts are to be interpreted according to the law applicable to contracts between private individuals. *Ibid.*

No principle of general contract law exempts the United States from the promises made in the 1951 Agreement. Nor is the United States permitted to repudiate the Agreement simply because the federal government is a sovereign. Rather, "the right to make binding obligations is a competence attaching to sovereignty." *Perry v. United States*, 294 U.S. 330, 353 (1935). The 1951 Agreement involves no surrender of the essential attributes of governmental sovereignty; Congress remained fully free thereafter to legislate on the subject of state and local employee Social Security coverage in any otherwise constitutional general manner.

The United States is prohibited from repudiating the 1951 Agreement not only by federal common law of contract, but also by the Just Compensation and Due Process Clauses of the Fifth Amendment. A valuable contractual "right" was taken from the appellees by the 1983 Amendment; the right to terminate the Agreement is worth literally billions of dollars to appellees.

4. When the United States repudiates its own contracts, the appropriate standard of review is suggested by *United States Trust Co. v. New Jersey*, 431 U.S. 1, 29 (1977)—the impairment must not only be for a public purpose, but must also be both "reasonable and necessary to serve" that purpose. Here, the repudiation of the 1951 Agreement was not necessary to achieve Congress' purpose of mitigating financial losses to the Social

Security system resulting from terminations of coverage of state and local employees. The 1983 Amendment and its legislative history contain numerous examples of other approaches, none of which involves the United States' repudiation of its contractual agreements. Because less drastic means to solve the problem were plainly available, abrogation of the 1951 Agreement was constitutionally impermissible.

ARGUMENT

Like the district court, we begin by emphasizing what this case is and is not about. It is *not* about the right of Congress to subject all state and local employees to coverage of the Social Security system. We assume *arguendo*, as did the district court, that such universal coverage would pass constitutional muster. See *Garcia v. San Antonio Metropolitan Transit Authority, supra.*[9]

Nor does this case present the question, faced by the Court in *National Railroad Passenger Corp. v. Atchison, Topeka & Santa Fe Railway Co.*, —— U.S. ——, 105 S.Ct. 1441 (1985), whether a statutory scheme in and of itself can be interpreted as a contract between the United States and a regulated party, Here, *amici* do not contend that the 1950 Amendments created a contract between the States and the United States. Rather, those Amendments simply authorized the Secretary to enter into voluntary agreements with those States that so desired. It is the 1951 Agreement between California and the United States, not the statute, that creates the contract here.

This case is also not concerned with whether general regulatory legislation by the Congress unconstitutionally impairs contractual obligations between two private parties. *Compare, e.g., Connolly v. Pension Benefit Guaranty Corp.*, Nos. 84-1555, 84-1567 (Feb. 26, 1986), slip op. 12; *National Railroad Passenger Corp.*, 105 S.Ct. at 1455-56. *Cf. Exxon Corp. v. Eagerton*, —— U.S. ——, 103 S.Ct. 2296 (1983); *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, —— U.S. ——, 103 S.Ct. 697 (1983); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) (Contract Clause cases). Rather, this case squarely presents the issue of the appropriate test when Congress abrogates the United States' *own* contractual obligations to the States, an issue expressly pretermitted by the Court in *National Railroad Passenger Corp.* (105 S.Ct. at 1455 n.24.)

In short, the sole issue presented by this case is whether the United States may, for an arguably laudable public purpose, simply ignore its contract with a State when the contractual duties become inconvenient or financially burdensome. *Amici* submit that the district court correctly held the United States to its agreement, and that the judgment below should be affirmed.

I. THE 1951 AGREEMENT BETWEEN CALIFORNIA AND THE UNITED STATES IS A CONTRACT

The 1951 Agreement concerning California's voluntary participation in the Social Security system has all the facial indicia of a contract. As this Court has noted in an analogous context, "[a]ll the elements of a contract met in the transaction—competent parties, proper subject-matter, sufficient consideration, and consent of minds." *McGee v. Mathis*, 71 U.S. (4 Wall.) 143, 155 (1866). The Agreement is signed by authorized parties, imposes mutual legal obligations on the parties, and envisions a specific performance. *See generally* Restatement (Second) of Contracts § 1 (1981).

Nonetheless, the Secretary argues that the Agreement is not truly a contract because it was entered into in order to implement a general scheme of regulation. (U.S. Br. at 18-19.) The argument does not withstand analysis.

[9] We also assume *arguendo* that Congress could subject the employees of selected States and subdivisions to coverage under the system, if there were a rational basis for the inclusion of such employees and the exclusion of others.

It is, of course, common ground that when Congress establishes a legislative program, "the presumption is that 'a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.'" *National Railroad Passenger Corp.*, 105 S.Ct. at 1452 (quoting *Dodge v. Board of Education*, 302 U.S. 74, 79 (1937)). See U.S. Br. at 19-20. This presumption, however, is wholly inapplicable in the case at hand. As this Court has noted in the very cases upon which the United States relies, "'[i]f [the law] provides for the execution of a written contract *on behalf of the state* the case for an obligation binding upon the state is clear.'" *National Railroad Passenger Corp.*, 105 S.Ct. at 1452 (quoting *Dodge v. Board of Education*, 302 U.S. at 78) (emphasis in original).

The 1950 Amendments plainly provide for the execution of a "written contract" on behalf of the United States; the 1951 Agreement is that contract. The section of Pub. L. No. 98-21 that added Section 418 to the Act was entitled "*Voluntary Agreements* For Coverage of State and Local Employees." (Emphasis added.) Subsection (a)(1) of Section 418 expressly authorizes negotiation by the parties, and inclusion in the agreements, of "such provisions, not inconsistent with the provisions of this section, as the State may request."

It would be difficult to draft statutory language that more directly contemplates the execution of a written contract. Moreover, the history of the 1950 Amendments clearly indicates that Section 418 was passed in order to allow the States to determine whether or not to enter into voluntary contractual agreements with the federal government concerning Social Security. There was considerable doubt at the time of the Amendments about the power of Congress to subject the States to the system. (H.R. Comm. Print 97-34, at 2-3.) In addition, there was substantial political opposition among the States and state and local employees to subjecting such

employees to the system, particularly in light of the wide coverage of state retirement plans. *Id.* at 20. For these reasons, Congress concluded that "all coverage of State and local employees must be on a voluntary basis." S. Rep. No. 1669, 81st Cong., 2d Sess. 14 (1950). *See also* H.R. Comm. Print 97-34, at 2 ("coverage had to be voluntary").

The right to terminate such voluntary agreements on two years' notice was viewed by Congress as "consistent with the voluntary approach to coverage" (H.R. Comm. Print 97-34, at 20), and a "necessary corollary" to the voluntary approach. *Id.* at 3. *See also* S. Rep. No. 1669, *supra*, at 14 (termination provision designed "[i]n order to safeguard the interest of all parties concerned"). Under any realistic analysis, the right to terminate was offered to the States as an inducement to enroll state and local employees in the system, in order to make the voluntary agreements authorized by Section 418 more attractive to state and local governments. California signed the 1951 Agreement with the clear understanding that it was acquiring thereby not only coverage of specified employee groups, but also the right to terminate such coverage on two years' notice.[10]

In short, the 1950 Amendments were designed to give the States a choice. They could either remain outside the Social Security system, or they could contract to enter it. The contract contemplated by the Amendments—and signed by California—offered not only employee coverage, but the right to terminate such coverage on specified notice. As the district court found, the termination clause in the 1951 Agreement was "one of the motivating causes of [California's] making the contract." (J.S. App. 22a.) Once having persuaded California to sign an agree-

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[10] Indeed, California so plainly believed that it had such a right that it offered local subdivisions contracting for Social Security coverage precisely the same option. See Cal. Gov't Code § 22310 (West Supp. 1985).

ment containing explicit language spelling out the right to terminate, the United States can now hardly argue that such language is not a matter of contract.

Indeed, in the context of federal grant programs, this Court has repeatedly found the existence of contracts between the United States and state governments in far less compelling circumstances. In *Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1 (1981), even in the absence of a formal written agreement, the Court held that "legislation enacted pursuant to the spending power is much in the nature of a contract: in return for federal funds, the States agree to comply with federally imposed conditions." *Id.* at 17.[11]

Given the legislative history of the 1950 Amendments and the presence of a written agreement, no different conclusion is possible here. Nor is the 1951 Agreement deprived of its contractual character by virtue of the general language in 42 U.S.C. 1304 reserving to Congress the "right to alter, amend, or repeal any provision of the [Social Security Act]." As this Court stated in *National Railroad Passenger Corp.*, 105 S.Ct. at 1453, such language may well be powerful proof that a statute, in and of itself, was not intended to create contractual rights. But here, as the district court noted, Congress' right to amend the statute whenever it pleases is not at issue; what is at issue is Congress' right unilaterally to amend the Agreement. (J.S. App. 31a-32a.) The reservation clause simply allows Congress "to provide for what shall be done in the future, and . . . what preparation shall be made for the due performance of contracts already entered into." *Sinking-Fund Cases*, 99 U.S. (9 Otto) 700, 721 (1879). Such reservation language does

[11] The principle is hardly of recent origin. In 1866, Chief Justice Chase stated in *McGee v. Mathis*, 71 U.S. (4 Wall.) at 155: "It is not doubted that the grant by the United States to the State upon conditions, and the acceptance of the grant by the State, constituted a contract."

not enable the United States to "undo what has already been done, and it cannot unmake contracts that have already been made." *Ibid.*

II. THE UNITED STATES CANNOT UNILATERALLY ABROGATE ITS CONTRACT WITH CALIFORNIA

It has long been settled that:

> The United States are as much bound by their contracts as are individuals. If they repudiate their obligations, it is as much repudiation, with all the wrong and reproach that term implies, as it would be if the repudiator had been a State or a municipality or a citizen.

Sinking-Fund Cases, 99 U.S. (9 Otto) at 719. As Justice Brandeis stated in his opinion for the Court in *Lynch v. United States*, 292 U.S. 571, 579 (1934), "[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals." 292 U.S. at 579. *See also Perry v. United States*, 294 U.S. 330, 352 (1935) ("When the United States, with constitutional authority, makes contracts, it has rights and incurs responsibilities similar to those of individuals who are parties to such instruments."); *S.R.A., Inc. v. Minnesota*, 327 U.S. 558, 564 (1946) ("Normally contracts between the United States and others are construed as contracts between private parties.")

The Secretary does not contend that, had the 1951 Agreement been between two private parties, some general tenet of contract law would have allowed one party unilaterally to excise from the contract the right of the other to terminate the arrangement on two years' prior notice. Rather, the Secretary contends that because the United States is a sovereign, such ordinary principles of contract do not restrict its power to repudiate its promises. The argument is not only contrary to the

Sinking-Fund Cases and their progeny; it also has been expressly rejected by this Court.

In *Perry*, the United States argued that it had the right to repudiate the gold clause in Government bonds, since "the government cannot by contract restrict the exercise of a sovereign power." 294 U.S. at 353. In rejecting the argument, Chief Justice Hughes noted that "the right to make binding obligations is a competence attaching to sovereignty." *Ibid.*[12] The Court's opinion quoted with approval from Alexander Hamilton's communication to the Senate of January 20, 1795 (3 Hamilton's Works 518, 519), to the effect that

> "[W]hen a government enters into a contract with an individual, it deposes, as to the matter of the contract, its constitutional authority, and exchanges the character of legislator for that of a moral agent, with the same rights and obligations as an individual. Its promises may be justly considered as excepted out of its power to legislate, unless in aid of them. It is in theory impossible to reconcile the idea of a promise which obliges, with a power to make a law which can vary the effect of it."

294 U.S. at 351 n.2.

Nothing in the 1951 Agreement takes it outside the scope of these basic rules. The fact that the Agreement is between the United States and a State, rather than between the federal government and an individual, hardly reduces its contractual status. This Court has repeatedly emphasized that the States are bound to honor their contractual promises to the United States. *See, e.g., Bell v. New Jersey*, 461 U.S. 773 (1983); *Pennhurst State School and Hospital v. Halderman, supra; McGee v.*

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[12] *Cf. Bell v. New Jersey*, 461 U.S. 773, 790 (1983) ("Requiring States to honor the obligations voluntarily assumed as a condition of federal funding . . . simply does not intrude on their sovereignty.").

Mathis, supra. The analysis perforce is bilateral; if the States are bound by contract to honor their obligations to the United States, then the United States in turn must be bound by its contractual promises to the States.

The 1951 Agreement is not somehow exempt from the sweep of this Court's prior decisions simply because it does not embody a traditional business transaction or "investment-backed expectations." (U.S. Br. at 43). In *Lynch*, this Court expressly rejected the contention that contracts "not entered into by the United States for a business purpose" were entitled to different weight than those involving borrowings or other forms of finance. 292 U.S. at 576. Although the War Risk insurance program was, in the Court's view, analogous in "benevolent purpose" to other benefits programs for veterans, Justice Brandeis nonetheless squarely held that "the policies, albeit not entered into for gain, are legal obligations of the same dignity as other contracts of the United States and possess the same legal incidents." *Ibid. Cf. FHA v. The Darlington, Inc.*, 358 U.S. 84, 93-98 (1958) (Harlan, J., dissenting) (applying *Lynch* analysis to FHA mortgage).

Similarly, the Secretary's argument that the United States may not contract away its sovereign powers, while stating a basic axiom, misses the mark here. First, as this Court held in *United States Trust Co. v. New Jersey*, 431 U.S. 1, 23 (1977), "a contract that surrenders an essential attribute of [governmental] sovereignty" is "invalid *ab initio*." Here, far from treating the 1951 Agreement as invalid, the United States instead seeks to have it both ways; it attempts to hold appellees to their bargain under the 1951 Agreement, while at the same time rewriting the bargain. No decision of this Court remotely supports such an approach.

More important, the 1951 Agreement in no way involves the surrender of an essential attribute of the federal government's sovereignty. Congress retains full power to

legislate on the subject of Social Security coverage of state and local employees. It is basic that the United States "cannot be held liable for an obstruction to the performance of the particular contract resulting from its *public and general acts* as a sovereign." *Horowitz v. United States*, 267 U.S. 458, 461 (1925) (emphasis supplied). *See also Lichter v. United States*, 334 U.S. 742 (1948) (War Contracts Renegotiation Act not taking of private property); *Thorpe v. Housing Authority of Durham*, 393 U.S. 268 (1968) (general regulations permissible even when they impose upon a housing authority an additional obligation not contained in contract with HUD). Thus, as we have already noted, it may be assumed *arguendo* that Congress, in 1983, could have simply decided to subject all state and local employees to coverage, even though such a general act would have rendered the right to withdraw in the 1951 Agreement practically meaningless.

The 1983 Amendment, however, is most assuredly not a "public and general" piece of legislation that coincidentally affects rights of California under the 1951 Agreement. Rather, as the district court held, "Congress clearly and explicitly intended to deprive the plaintiffs of their right to withdraw from the contract." (J.S. App. 33a.) In this respect, the 1983 Amendment is no different than the legislation struck down in *Lynch*. There, Congress sought to relieve the financial burdens of the Great Depression by explicitly renouncing its obligations under insurance contracts; here, it sought to mitigate the financial difficulties faced by the Social Security system by explicitly renouncing contractual obligations to the States.

In short, nothing in the sovereign nature of the federal government exempts the 1951 Agreement from 'the law applicable to contracts between private individuals." *Lynch*, 292 U.S. at 579. Because it is settled that federal common law controls questions concerning "[t]he validity and construction of contracts through which the

United States is exercising its constitutional functions" (*United States v. Allegheny County*, 322 U.S. 174, 183 (1944)), the district court's judgment should be affirmed as a matter of contract law alone.

But, as the district court noted, when the United States enters into a contract, its obligations thereafter are dictated by more than just contract law. "Contract rights are a form of property" (*United States Trust Co.*, 431 U.S. at 19 n. 16), and thus "[r]ights against the United States arising out of a contract with it are protected by the Fifth Amendment." *Lynch*, 292 U.S. at 579. *See also United States v. Central Pacific Railroad Co.*, 118 U.S. 235 (1886). Accordingly, the United States is barred from repudiating its contractual duties by both the Just Compensation Clause and the Due Process Clause. *Lynch*, 292 U.S. at 579. *See also Thorpe*, 393 U.S. at 278-79 & nn. 31-33 (Due Process Clause prohibits repudiation of contract obligations by United States).[13]

In an attempt to avoid the holding in *Lynch*, the Secretary argues that "the economic effect of the challenged legislation is not so great as to amount to a taking" (U.S. Br. at 44), because California will remain able to participate in the Social Security system in the future.

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[13] This Court has held that States are not "persons" within the purview of the Fifth Amendment's Due Process Clause. *South Carolina v. Katzenbach*, 383 U.S. 301, 323-24 (1966). The district court, however, was correct in holding that both the appellee political subdivisions and the individual employees had standing to raise that constitutional objection to the 1983 Amendments. *Cf. Monroe v. Pape*, 365 U.S. 167 (1961) (municipality a "person" under 42 U.S.C. § 1983); *Thorpe*, 393 U.S. at 278-79 (considering due process arguments by local housing authority).

In any event, it is settled that the Fifth Amendment's prohibition against the taking of "private property" without just compensation applies to the taking of the property of state and local governments. *United States v. 50 Acres of Land*, —— U.S. ——, 105 S.Ct. 451, 456 (1984).

What the Secretary fails to recognize, however, is that California—and the other contracting States—must, under the 1983 Amendment, continue to pay large sums of money to the Secretary for coverage of employees of political subdivisions that no longer desire such coverage. Indeed, the Secretary's brief concedes that if the States are allowed to exercise their contractual rights to withdraw, the total annual savings for them and the affected employees will be in the area of $500 million to $1 billion. (U.S. Br. at 7). By any applicable constitutional measure, such an effect is hardly *de minimis*.[14]

In this case, the record plainly demonstrates that the "economic effect" of such forced expenditures upon the appellees is substantial. Officials of two California cities submitted affidavits—uncontroverted by the United States—attesting that eliminating expenditures for Social Security coverage of their employees (who are already covered under the California Public Employees Retirement System) will allow the municipalities to avoid reductions in essential services and layoffs of many of the covered employees (J.A. 64-73).[15] One may reasonably question whether such a course of action would involve good social policy. It is plain, however, that the economic effect of the 1983 Amendment is enormous; the contract right embodied in the termination clause is worth billions of dollars to the States.[16]

Under any realistic analysis, the 1983 Amendment explicitly annulled valuable contract rights of the appellees under the 1951 Agreement. Although the Secretary argues that such action was undertaken in the

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[14] Here, unlike *Connolly v. Pension Benefit Guaranty Corp.*, the amounts that the States are required to pay under the contracts are being taken for the use of the United States. *See id.*, slip op. 12.

[15] For this reason, the employees of one of the cities initiated the discussion which culminated in the decision to withdraw from the Social Security system. (J.A. 65).

[16] In 1982-83, for example, California paid over $1.3 billion to the United States under the 1951 Agreement. (J.A. 51).

public interest and for a public purpose, the same is necessarily true of any taking. *Cf. Hawaii Housing Authority v. Midkiff*, —— U.S. ——, 104 S.Ct. 2321, 2329 (1984) (public use requirement of the Just Compensation Clause is coterminous with the scope of a sovereign's police powers). A public purpose alone—however laudable—does not allow the United States to repudiate its contracts.

III. A HEIGHTENED STANDARD OF REVIEW IS APPLICABLE TO THE GOVERNMENT'S REPUDIATION OF ITS OWN CONTRACTS

The Secretary devotes much of his brief to arguing the beneficial effects on the Social Security system of the 1983 Amendment. The argument misses the point. If we were dealing here with the impairment of a private contract by federal legislation, the appropriate inquiry would be whether "the legislature has acted in an arbitrary and irrational way." *National Railroad Passenger Corp.*, 105 S. Ct. at 1455. But as Justice Marshall noted in *National Railroad Passenger Corp.* (*id.* at 1455 and nn. 24-25), the allegation of a government's breach of its *own* contract presents a quite different matter.

Under the minimal standard of review proposed by the Secretary, no contract with the federal government would be worth the paper it is printed on. In *Lynch*, for example, it could surely have been concluded that the financial exigencies of the Depression justified reduction of some non-essential federal expenditures; it could hardly have been argued that war risk term insurance was central to the survival of the Republic. Indeed, it would be difficult to imagine a circumstance where *some* rational, non-arbitrary reason could not be offered for the repudiation of a contractual obligation by the federal government.[17]

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[17] *Cf. United States Trust Co.*, 431 U.S. at 26:

> A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State

Amici submit that here, as the Court suggested in *National Railroad Passenger Corp.*, a "heightened standard of review" must apply when the federal government repudiates its own contracts. The appropriate standard, we believe, is found in *United States Trust Co.*, which was decided in the context of a State's breach of its contractual obligations. There, the Court explicitly rejected the "invitation to engage in a utilitarian comparison of public benefit and private loss" in determining the legality, under the Contract Clause, of the State's repudiation of its promises. 431 U.S. at 29. Rather, such an impairment of the State's own contract could be sustained only "if that impairment was both reasonable and necessary to serve the admittedly important purposes claimed by the State." *Ibid.*

The *United States Trust Co.* test is applicable here.[18] Since the federal government's "self-interest is at stake" (*id.* at 26), Congress simply "is not completely free to consider impairing the obligations of its own contracts

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could reduce its financial expenditures whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.

For similar reasons, a minimal standard of review does not apply under the Fifth Amendment to federal legislation repudiating government contracts. (*Id.* at 26 n.25, citing *Perry* with approval).

[18] This Court has suggested that the principles embodied in the Due Process Clause are not necessarily coextensive with those in the Contract Clause, and that, to the extent the standards differ, a less searching inquiry may be applicable in the review of federal economic legislation. *Pension Benefit Guar. Corp. v. R. A. Gray & Co.*, —— U.S. ——, 104 S.Ct. 2709 (1984); *Nat'l R.R. Passenger Corp.*, 105 S.Ct. at 1455 n.25. These statements, however, were made in the context of federal legislation that was alleged to have impaired private contracts, not contracts involving the United States as a party. As *National Railroad Passenger Corp.* suggests (citing *Lynch*, *Perry*, and *United States Trust Co.*), this standard of review is not necessarily applicable when a government impairs its own contractual obligations. *Id.* at 1455 nn.24-25. *See also United States Trust Co.*, 431 U.S. at 26 n.25.

on a par with other policy alternatives." *Id.* at 30-31. Rather, the appropriate inquiry is a "less drastic means" test; the burden is on the federal government to demonstrate that "an evident and more moderate course would [not] serve its purpose equally well." *Id.* at 31.

The Secretary makes no such contention here. Indeed, the 1983 Amendment itself plainly suggests several alternative approaches not involving the repudiation of the 1951 Agreement. In the case of federal employees, for example, the Amendment required that all *new* employees be enrolled in the system. (Pub. L. No. 98-21, § 191, 97 Stat. 67.) In the case of employees of nonprofit organizations, who, like the States, had contractual rights to withdraw from the system pursuant to agreements entered into after the 1950 Amendments, Congress simply chose to subject *all* such employees to coverage. (*Id.*, § 102(a)(1), 97 Stat. 70.) And the Secretary's own brief acknowledged that Congress could have simply "ignored the outstanding agreements" and instead enacted legislation subjecting all (or a specified subgroup) of the employees of state and local subdivisions to Social Security coverage. (U.S. Br. at 29.)

In short, it is uncontested that it was not necessary for Congress to repudiate the 1951 Agreement to achieve its goal of aiding the Social Security system financially. The fact that Congress could have reached the same end through permissible means hardly serves, as the Secretary suggests, to render "absurd" the argument that the federal government's repudiation of its contracts is constitutionally impermissible. (U.S. Br. at 30.) The Fifth Amendment—like much of the Constitution—is largely about *process*, not results. It is permissible under the Constitution to deprive a person of life, liberty, or property only after due process of law. Just as it is no answer to a valid Fifth Amendment claim in the criminal context to say that a fair trial would surely have produced the same result, it is no answer in this case for

the Secretary to contend that a different legislative approach might constitutionally lead to the same practical result. Indeed, because it is plain that it was not necessary for Congress to repudiate the 1951 Agreement in order to avoid financial loss to the system, its decision nonetheless to abrogate its agreements with the States is wholly indefensible.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted,

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